Volume 57
Issue 1 *Dickinson Law Review - Volume 57, 1952-1953*

10-1-1952

Recent Case

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BILLS AND NOTES—PRINCIPAL AND AGENT—BANKS AND BANKING—RIGHT OF UNDISCLOSED PRINCIPAL TO SUE ON CONTRACT MADE BY HIS AGENT

The factual situation in a recent New Jersey case, *Goldstein* v. *Commonwealth,*[1] is as follows:

Morris Silver, a New Jersey attorney, acting as the agent of the plaintiffs, drew a check in the amount of $5000 on an account he as agent had with the Commonwealth Trust Company. The plaintiffs, Nathan Goldstein and another, were co-partners trading under the firm name, Comet Embroidery Company. The plaintiffs' names did not appear on the check. The instrument was payable to Grantwood Electric, a New Jersey corporation. The complaint alleged that the check was indorsed on behalf of the payee without authority. Later the instrument was presented for payment and the Commonwealth Trust Company charged the same to Silver's account. The plaintiffs, believing that the check was improperly honored, demanded judgment against the Commonwealth Trust Company for the full amount of the instrument.

The Trust Company of New Jersey was brought in by the Commonwealth Trust Company as third-party defendant, because it had accepted the check for deposit and, in indorsing it for payment, guaranteed all prior indorsements.

A motion was made by the third-party defendant, in which the defendant and third-party plaintiff joined, to strike the plaintiffs' complaint on the grounds that it failed to state a cause of action against either of the moving parties.

Ostensibly the attorney, Morris Silver, had some of plaintiffs' funds deposited in his attorney's account which was labeled "Special Account." Therefore, the plaintiffs advanced the theory that the cause of action was not one based on a negotiable instrument but rather upon breach of contract. They contended that the cause of action was based on the implied contract between the bank and its depositor, Silver, and that they, therefore, could sue as the real parties in interest by reason of their contention that they were the undisclosed principals of Silver who acted as their agent.

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If the cause of action had been based solely upon the negotiable instrument, the plaintiffs, not being parties to it, would have had the overwhelming weight of authority against their recovery. Where a negotiable instrument is the basis of an action, an undisclosed principal may not institute legal proceedings.[2] This

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[1] Goldstein *et. al.* v. Commonwealth Trust Co. (Trust Co. of New Jersey, third-party defendant), 19 N.J. Super. 39, 87 A.2d 555 (1952).

[2] Heart of America Lumber Co. v. Belove, 111 F.2d 525, 130 A.L.R. 658 (1940).

is the corollary of the well-settled canons (1) that an undisclosed principal may not be subjected to an action at law on a negotiable instrument signed by his agent alone and (2) that liability on a negotiable instrument generally is limited to the parties whose signatures appear thereon.[3]

However, since the plaintiffs had advanced the contract theory rather than the negotiable instrument concept, the first problem which confronted the New Jersey court was to consider the nature of the relationship which existed between Silver, the depositor, and the Commonwealth Trust Company, the depository-bank.

In so far as general deposits are concerned, the relationship between a bank and its depositors is that of creditor and debtor. Out of this debtor-creditor relationship have arisen mutual duties and obligations. One of those is the obligation imposed on the bank to pay out money only on the depositor's direction and in accordance with his order. Therefore, it is evident that when a depository-bank disburses money on an instrument which does not bear a genuine indorsement of the depositor-creditor, the bank cannot legally charge the disbursement to the depositor's account if the depositor-creditor was not at fault. The bank has not acted on an order of the creditor.

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The next issue which the court had to consider was the status of the plaintiffs. Could they also be classified depositors? If so they could maintain this suit and recover judgment. However, the court concluded that the plaintiffs were not depositors and, therefore, the motion to strike the complaint was granted. The learned judge in his opinion said:

> "The fact that the account here involved is an attorney's account specifically labeled 'Special Account' does not *per se* enlarge the duties or obligations of a bank to include others than the depositor. In my view, an account such as this has no greater status than any ordinary general deposit in so far as a bank's liabilities are concerned. It is argued in part that the labeling of the account was of such a nature as to give notice to the bank of the fact that their depositor was acting merely as an agent or fiduciary. Although notice to the bank is not indispensible to the plaintiffs' theory of recovery, I am compelled to recognize judicially that special attorneys' accounts may not only contain clients' funds but also funds belonging to the attorneys themselves. The best, then, that can be said for the plaintiffs' proposition is that a bank has knowledge that the attorney may be disbursing funds not his own. Consequently, in any given transaction, a bank's knowledge is inadequate to charge it with notice that it is in fact acting for a principal other than the depositor. Regardless, even in a situation where a bank had adequate notice that an account was held by a depositor only in a fiduciary capacity, it has been held that the bank's obligation runs to the trustee-depositor and that

[3] Briggs v. Partridge, 64 N. Y. 357 (1876); Kempner v. Dillard, 100 Tex. 505, 101 S.W. 437 (1907); Pease v. Pease, 35 Conn. 131 (1868).

> it owes no duty to the trust estate save to refrain from participating in misappropriating the funds. . . .An action cannot lie for a breach of a duty in favor of one to whom the duty was not owed. Only a person to whom the duty is owed can recover for neglect of duty or obligation, whether such exists at common law or is imposed by statute."

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An undisclosed principal may, however, maintain in his own name a suit for the breach of an ordinary contract.[4] The majority of American courts generally follow the well-established rule that an undisclosed principal has all the rights against a third person who contracted with his agent that he would have had if he had been a disclosed principal, unless the application of this rule would injure the third person. But in this case the New Jersey court felt it was concerned with a contract unlike the ordinary one. The court pointed out it was possible to perceive three separate contracts:

> ". . . first, the primary one between the plaintiffs and the payee of the check wherein the depositor is acting as attorney for the plaintiffs; second, the contract as embodied in the negotiable instrument; and finally, the contract arising between Commonwealth Trust Company and Silver as a result of Silver's deposit."

The latter contract, implied in law, was the one with which the court was here concerned. The court felt that the bank was the mere instrumentality through which the primary contract was partially accomplished. Therefore, rather than occupying the status of an undisclosed principal, the plaintiffs' position would be more accurately described as an incidental beneficiary, having no right to institute legal proceedings.

The court also based its decision on grounds of public policy. The judge in his opinion reasoned that to extend the bank's liability to include those who may stand hidden behind the depositor with whom the bank had openly conducted business would seriously impair commercial transactions and cause a prodigious reduction in the flow of negotiable instruments.

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To reiterate in summation, the *Goldstein* decision is significant because it guarantees a continuance of the free flow of negotiable instruments. To allow the plaintiffs to stand unnoticed behind the depositor and recover judgment would be unconscionable. To extend the banks' liability beyond its present scope would impose a serious burden on commercial transactions and prevent the free flow of negotiable instruments. Then too, if the plaintiffs had been successful in this action, it is conceivable that Silver, the depositor, could later bring an action against the drawee-bank to have it recredit the amount of the check.

Robert H. Griffith
Member of the Senior Class

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[4] Rich v. Bongiovanni, 4 N.J. Super. 243, 66 A.2d 888 (1949).